ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Correa | Analyst: Roger Lackey | Bill Number: AB 10

Related Bills: See Legislative History | Telephone: 845-3627 | Introduced Date: 12-07-98

Attorney: Doug Bramhall | Sponsor:

SUBJECT: Minimum Franchise Tax/Qualified New Corporations/Exempt First Year and Reduce Prepaid to $300

SUMMARY

This bill would provide that a qualified new corporation shall not be subject to the prepayment to the Secretary of State (SOS) for its first income year, but subject to a prepayment to the SOS of $300 for each subsequent income year. In addition, the bill provides that a qualified new corporation shall not be subject to the minimum franchise tax for its first taxable year and shall pay a minimum franchise tax of $500 for its second taxable year.

EFFECTIVE DATE

This bill would be operative for income years beginning on or after January 1, 2000.

LEGISLATIVE HISTORY

AB 2798 (Stats. 1998, Ch. 323), AB 27 (1998), SB 842 (1997), SB 510 (1997), AB 8 (1997), AB 27 (1997), SB 38 (Stats. 1996, Ch. 954), AB 546, AB 3298, AB 3010, AB 3394 (1996); AB 647, AB 744, AB 1098 (1995); AB 411, AB 977, AB 1721, AB 2886, AB 3807 (1993/94); AB 3506, SB 1453 (1992); AB 4275 (1989/90); SB 572 (Stats. 1987, Ch. 1139); AB 1 (Stats. 1971, Ch.1); AB 1175 (Stats. 1957, Ch. 1127).

PROGRAM HISTORY/BACKGROUND

The minimum franchise tax was established to ensure that all corporations pay at least a minimum amount of franchise tax for the privilege of doing business in this state, regardless of the corporation's level of income (or loss). The minimum franchise tax has varied over the years. For income years ending before June 25, 1959, the minimum franchise tax is $25. For income years ending after June 25, 1959, and beginning before January 1, 1972, the minimum franchise tax is $100. For income years beginning after December 31, 1971, and before January 1, 1987, the minimum franchise tax is $200. For income years beginning after December 31, 1986, and before January 1, 1989, the minimum franchise tax is $300 (SB 572, Stats. 1987, Ch. 1139). This tax was increased to $600 for income years beginning on or after January 1, 1989, and before January 1, 1990, and to $800 for income years beginning on or after January 1, 1990. Beginning on January 1, 1999, a "qualified new corporation," as defined, pays a $500 minimum franchise tax for its second taxable year. The minimum franchise tax is $25 for certain gold and quicksilver mining corporations. Credit unions, certain nonprofit

Board Position:

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Department Director: **Gerald Goldberg** Date: **1-28-99** cooperative associations, and exempt organizations are not subject to the minimum franchise tax.

Corporations prepay the minimum franchise tax to the Secretary of State (SOS) at the time they incorporate (California corporation) or initially qualify (non-California corporation) with that office to do business in this state. This initial payment constitutes the taxpayer's initial franchise tax return. For income years beginning on or after January 1, 1997, and before January 1, 1999, the prepayment to the SOS is reduced to $600 for a “qualified new corporation,” as defined. For income years commencing on or after January 1, 1999, the prepayment to the SOS for a “qualified new corporation,” definition revised, is reduced to $300. If a non-California corporation commences to do business in this state without qualifying with the SOS, the FTB assesses the initial minimum franchise tax.

SPECIFIC FINDINGS

Under existing state law, unless specifically exempted by statute, every corporation that is organized or qualified to do business or doing business in this state (whether organized in state or out-of-state) is subject to the minimum franchise tax. Taxpayers must pay the minimum franchise tax only if it is more than their measured franchise tax. For income years beginning on or after January 1, 1997, only taxpayers whose net income is less than approximately $9,040 pay the minimum franchise tax because their measured tax would be less than $800 ($9,039 x 8.84% = $799).

Existing state law provides that real estate mortgage investment conduits (REMICs) are subject to and required to pay the minimum franchise tax. Regulated investment companies (RICs) and real estate investment trusts (REITs) organized as corporations also are subject to and required to pay the minimum franchise tax.

Under existing state law, the tax on limited partnerships (LPs), limited liability companies (LLCs), and limited liability partnerships (LLPs) is set at $800 by reference to the amount provided in the minimum franchise tax statute.

Existing state law provides for income years commencing on or after January 1, 1997, and before January 1, 1999, a reduced prepayment of tax to the SOS of $600 for a “qualified new corporation” with gross receipts, less returns and allowances, reportable to this state of less than $1 million. The reduced tax applies only to the prepayment payable to the SOS in connection with incorporation or registration with the SOS.

For income years beginning on or after January 1, 1999, the prepayment to the SOS for the first income year of a “qualified new corporation” is $300, and the minimum franchise tax for its second taxable year is $500. A “qualified new corporation” does not include any corporation that began business operations as a single proprietorship, a partnership, or any other form of business entity prior to its incorporation. To be eligible for the reduced prepayment and minimum franchise tax, the qualified new corporation must be incorporated on or after January 1, 1999.

Also, **existing state law** provides that the determination of whether a corporation meets the gross receipts criterion is based on the aggregate gross receipts of the members of a commonly controlled group. The law defines "gross receipts less returns and allowances reportable to this state" as including both business and non-business receipts.

The reduced minimum franchise tax does not apply to any corporation if 50% or more of its stock is owned by another corporation. In addition, it does not apply to certain entities such as limited partnerships, limited liability companies, and charitable corporations required to pay the minimum franchise tax as a result of failure to file with the Attorney General.

For income years beginning on or after January 1, 1997, and before January 1, 1999, a corporation that paid $600 to the SOS must pay an additional tax of $200 on the due date of its first return, without regard to extension, if its gross receipts exceed $1 million or its tax liability exceeds $800. For income years beginning on or after January 1, 1999, a corporation that paid $300 to the SOS must pay an additional $500 if it does not meet the requirements of a "qualified new corporation," in its first income year, and if it paid $500 minimum franchise tax for its second taxable year, the corporation must pay an additional $300 if it fails to meet the requirements in its second taxable year.

This bill would provide for income years commencing on or after January 1, 2000, the prepayment to the SOS for the "qualified new corporations" first income year shall be $0, and $300 for each subsequent income year.

Also, **this bill** would provide that for income years beginning on or after January 1, 2000, a "qualified new corporation" shall not be subject to the minimum franchise tax for the first taxable year, and for the second taxable year the "qualified new corporations" shall pay a minimum franchise tax of $500.

Implementation Considerations

This bill makes overlapping and apparently incompatible changes to the general minimum franchise tax code section (Section 23153) and the minimum franchise prepayment code section (Section 23221).

The author's staff indicated that the author's intent is to provide "qualified new corporations" an exemption from the prepayment to the SOS. Therefore, amendments 1, 2, and 3 are provided to reflect the author's intent.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs once the implementation concerns are resolved.

Tax Revenue Estimate

Revenue losses under the Bank & Corporation Tax Law are as follows:

Effective for Income Years Beginning January 1, 1999 Enactment Assumed After June 30, 1999 (in millions		
1999-0	2000-1	2001-2
($3)	($5)	($6)

This estimate assumes that it was not the author's intent to require a "qualified new corporation" to pay the SOS $300 for each subsequent income year after incorporation.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

Revenue losses would depend on the number of corporations that are newly formed corporations (first-time businesses) with less than $1 million in gross receipts.

It is projected that the number of newly for corporations (first-time businesses) with less than $1 million in gross receipts benefiting from the repeal of the $300 Secretary of State fee will be approximately 18,500 for the year 2000.

BOARD POSITION

Pending.

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FRANCHISE TAX BOARD'S PROPOSED AMENDMENTS TO AB 10
As Introduced December 7, 1998

AMENDMENT 1

On page 2, line 1, strikeout all after "Section 1." through page 5, line 28. On page 5, line 29, strikeout "Sec. 2."

AMENDMENT 2

On page 6, line 11, after "1999" insert:

and before January 1, 2000,

AMENDMENT 3

On page 6, strikeout lines 17 and 18 inclusive, and insert:

($0).